SUPREME COURT, U. S
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In the

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1974

No. 74-1149

THE FIRST NATIONAL BANK AND TRUST COMPANY,
CHICKASHA, OKLAHOMA,
Petitioner,

VERSUS

THE CONTINENTAL INSURANCE COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS TENTH CIRCUIT

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The petitioner, THE FIRST NATIONAL BANK AND TRUST COMPANY, CHICKASHA, OKLAHOMA, prays that a writ of certiorari issue to review the opinion and judgment of the United States Court of Appeals for the Tenth Circuit rendered in these proceedings on the 10th day of January, 1975.

OPINIONS BELOW

The trial court, the United States District Court for the Western District of Oklahoma, wrote no opinion, but entered findings of fact and conclusions of law on the 14th day of November, 1973, which appear at Appendix A, *infra*, pp. i-xiv.

The judgment of the trial court entered November 16, 1973, appears at Appendix B, *infra*, pp. xv-xvi.

The United States Court of Appeals, Tenth Circuit, reversed the judgment of the United States District Court for the Western District of Oklahoma by opinion, as yet unpublished, appearing at Appendix C, *infra*, pp. xvi-xxvi.

Petition for rehearing, timely filed, was overruled by the United States Court of Appeals, Tenth Circuit, on the 29th day of January, 1975. The order overruling petition for rehearing appears at Appendix D, *infra*, pp. xxvi-xxvii.

The order staying mandate entered February 10, 1975, appears at Appendix E, *infra*, pp. xxvii-xxviii.

JURISDICTION

The opinion of the United States Court of Appeals, Tenth Circuit, was entered January 10, 1975. See Appendix C, p. xxvi, *infra*.

The Appellate Court entered its order denying petition for rehearing on the 29th day of January, 1975. See Appendix D, p. xxvii, *infra*.

The Appellate Court entered its order staying mandate on the 10th day of February, 1975. Pursuant to said order, the mandate was stayed to and including March 17, 1975, only, pending the timely filing by Appellee of a petition for a writ of certiorari in the Supreme Court of the United States. The order further provided that if on or before that date, the Clerk of the United States Court of Appeals for the Tenth Circuit should receive notice from the Clerk of the Supreme Court that a timely petition for certiorari has

been filed in that Court, the stay of mandate shall continue until final disposition by the Supreme Court.

The jurisdiction of the Supreme Court of the United States is invoked under 28 U.S.C., Sec. 1254(1).

QUESTIONS PRESENTED

This is an action by a bank against its insurance company on a Banker's Blanket Bond to recover for a false pretense loss suffered in a check kiting scheme. The insurance company defended claiming the loss was a loan loss and as such an excluded loss under the terms of the policy. The United States District Court, without a jury, found that the loss suffered by the bank was not a loan loss and granted judgment against the insurance company in the total amount of $175,871.81.

On appeal, the United States Court of Appeals for the Tenth Circuit reversed holding that the findings of fact and conclusions of law made by the trial court were clearly erroneous and not supported by the record.

The question thus presented is whether the Appellate Court properly exercised its appellate function under Rule 52(a) of the Federal Rules of Civil Procedure, which specifies that the findings of fact made by a District Court, sitting without a jury, are not to be set aside unless clearly erroneous or if the Appellate Court simply substituted its judgment for that of the trial court in determining the disputed fact question.

STATEMENT OF CASE

Petitioner, plaintiff in the trial court, was insured by THE CONTINENTAL INSURANCE COMPANY under Banker's Blanket Bond Standard Form No. 24. The bank filed suit against the insurance company in State Court to recover a loss under the bond. The case was removed to the United States District Court for the Western District of Oklahoma where a jury was waived and the case tried to the Court.

Petitioner's action sought recovery under coverage (B) of the Blanket Bond insuring against loss occasioned by false pretenses. The language of the bond affording coverage is, as follows:

> "(B) Any loss of Property through robbery, burglary, commonlaw or statutory larceny, theft, false pretenses, . . . whether effected with or without violence or with or without negligence on the part of any of the Employees, . . . etc."

The loss claimed arose in the following manner. The petitioner had done business for a number of years with W. C. Francis and Sons (Francis brothers), a Ford dealer in Blanchard, Oklahoma, a short distance from Chickasha. Francis maintained checking accounts in The First National, the petitioner bank, as well as in The First State Bank of Blanchard, Oklahoma.

On or about the 29th day of June, 1971, petitioner was notified by an officer of the Blanchard bank that FDIC examiners, in the Blanchard bank, suspected the Francis brothers of kiting checks between First National Bank and The First State Bank of Blanchard. The officer advised that

the Blanchard bank would be dishonoring and returning for insufficient funds checks which had been drawn by the Francis brothers on their account in the Blanchard bank, deposited to the Francis account in The First National and in due course presented to the Blanchard bank for payment. Subsequent investigation revealed that on the 28th and 29th days of June, 1971, a total of $65,124.29 in checks drawn on the Blanchard bank were presented by the Francis brothers to First National and $64,782.47 in checks drawn on The First National were deposited by the Francis brothers at Blanchard, all of these checks were insufficient at the time they were drawn. The Francis brothers had been given immediate credit by First National for the checks deposited on the 28th and 29th days of June, the credit had been exhausted and there remained only $962.85 in the account. Petitioner, knowing checks were being returned unpaid by the Blanchard bank, was faced with the prospect of an immediate overdraft loss in the Francis account. The president of First National called the Francis brothers into the bank to determine the facts with regard to the Francis transactions. The Francis brothers insisted that they were not engaged in a check kiting scheme and that their business dealings were legitimate.

Petitioner's situation was further complicated by the fact that in 1969 in order to assist the Francis brothers in paying for new Ford vehicles, C.O.D., petitioner had asked the Blanchard bank to issue Cashier's Checks or money orders payable to Ford in exchange for checks drawn by Francis on their account in The First National Bank. The Blanchard bank was advised that checks presented for Cashier's Checks or money orders payable to Ford would

bear a new Ford serial number and petitioner would guarantee payment of these checks.

On the morning of petitioner's meeting with the Francis brothers, June 30, 1971, the checks dated June 28 and June 29, drawn on the Francis account in First National, had arrived for payment. All of these checks bore on their face what purported to be new Ford serial numbers. As stated earlier, there was only a balance of $962.85 in the Francis account at that time. Petitioner could have returned the checks to the Blanchard bank dishonored for insufficient funds. However, the Francis brothers insisted that they were not kiting checks and because of the serial numbers on the face of the checks the bank officers believed that petitioner was obligated to the Blanchard bank on the terms of their guaranty. The bank faced an immediate loss on its guaranty, as well as on the checks being returned by the Blanchard bank. As near as the bank officers could calculate at that time, its loss was $83,760.50 and on that date, June 30, 1971, rather than show an immediate overdraft in the account and an immediate loss on the transaction and for the further purpose of protecting the capital structure of the bank and aiding it in recovery if in fact it were later determined that the Francis brothers' representations were not true and that there was in fact a loss, petitioner had the Francis brothers sign a note in the amount of $88,760.50. A few days later additional checks were returned insufficient from Blanchard which again would have shown an immediate overdraft and loss in the Francis brothers' account and the Francis brothers were asked to sign a second note in the amount of $33,302.22. It later developed that none of the checks drawn on the petitioner bearing serial

numbers were presented for Cashier's Checks or money orders, they were actually deposited and were a part of the check kite.

The Banker's Blanket Bond covers kite losses as a false pretense loss. However, there is an exclusion in the bond, excluding loss resulting from the nonpayment of a loan, whether fraudulently obtained or not. At trial, the United States District Court for the Western District of Oklahoma found that the petitioner's loss occurred when the insufficient funds checks drawn on the Blanchard bank were presented to petitioner, immediate credit given, that credit exhausted, and the checks thereafter dishonored; and further, that petitioner's loss on checks drawn on the petitioner bank occurred when the checks were paid to the Blanchard bank. The Court further held that the bank did not make the Francis brothers a loan when it asked them to sign the above mentioned notes.

The United States Court of Appeals for the Tenth Circuit found that the petitioner did make a loan to the Francis brothers when it asked the Francis brothers to sign the above two notes, holding that the trial court's findings to the contrary were clearly erroneous and not supported by the record. The Court of Appeals reversed the judgment of the trial court.

In addition to the check loss, the bank also suffered a loss of approximately $32,634.00 on new car floor plan notes secured by non-existent collateral and the purchase of commercial paper covering automobiles which were either nonexistent or which were sold and the proceeds not remitted. The trial court found that these losses occurred as a part of

an overall scheme to defraud both banks, and as such, were not loans as that term is understood in the banking industry and within the meaning of the loan loss exclusion. The Court of Appeals reversed this portion of the trial court's judgment as well. For reasons hereinafter discussed, petitioner's primary concern here is in regard to the check loss.

BASIS FOR FEDERAL JURISDICTION

Petitioner, THE FIRST NATIONAL BANK AND TRUST COMPANY, CHICKASHA, OKLAHOMA, a national banking corporation, doing business in Chickasha, Grady County, Oklahoma, filed a civil action against THE CONTINENTAL INSURANCE COMPANY, a New York Corporation, in the District Court of Grady County, Oklahoma. The amount in controversy exceeds $10,000.00. There being diversity of citizenship and the requisite jurisdictional amount required by 28 U.S.C., Sec. 1332, original jurisdiction of the cause lay in the United States District Court for the Western District of Oklahoma, and the cause was removed by THE CONTINENTAL INSURANCE COMPANY, pursuant to 28 U.S.C., Sec. 1441.

REASONS RELIED ON FOR ALLOWANCE OF WRIT

1. THE COURT OF APPEALS HAS NOT PROPERLY EXERCISED ITS APPELLATE FUNCTION.

Under the law of the State of Oklahoma, whether a transaction constitutes a loan of money is a question of fact not of form. *Cobb* v. *Baxter*, 292 P.2d 389 (Okla. 1956).

Petitioner respectfully contends that the United States Court of Appeals has not properly exercised its appellate function in accordance with the provisions of Rule 52(a)

of the Federal Rules of Civil Procedure, which provides in pertinent part, as follows:

> "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

Petitioner further contends that in considering the record below, the Appellate Court has weighed the evidence and substituted its judgment for that of the trial court. In so doing, the Appellate Court has "so far departed from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's power of supervision." Rule 19, Rules of the Supreme Court of the United States.

This Court has granted certiorari in order to consider action of Appellate Courts in similar circumstances and in *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100 at page 123, stated:

> "In applying the clearly erroneous standard to the findings of a district court sitting without a jury, appellate courts must constantly have in mind that their function is not to decide factual issues *de novo*. The authority of an appellate court, when reviewing the findings of a judge as well as those of a jury, is circumscribed by the deference it must give to decisions of the trier of the fact, who is usually in a superior position to appraise and weigh the evidence. The question for the appellate court under Rule 52(a) is not whether it would have made the findings the trial court did, but whether 'on the entire evidence (it) is left with the definite and firm conviction that a mistake has been committed.' United States v. United States Gypsum Co., 333 U.S. 364, 395. 68 S.Ct. 525, 542, 92 L.Ed. 746 (1948).

See also United States v. National Assn. of Real Estate Boards, 339 U.S. 485, 495-496, 70 S.Ct. 711, 717, 94 L.Ed. 1007 (1950); Commissioner of Internal Revenue v. Duberstein, 353 U.S. 278, 289-291, 80 S.Ct. 1190, 1198-1199, 4 L.Ed.2d 1218 (1960)."

2. DOES THE RECORD SUPPORT THE TRIAL COURT'S JUDGMENT?

Presentation of the case to the trial court required considerable documentary evidence, together with testimony of various bank officers concerning the business transactions and dealings and reasons for the action taken by the bank. As presented to the trial court, petitioner's loss was broken down into three distinct parts.

First, checks amounting to $65,124.29 drawn on the Blanchard bank negotiated at First National Bank for immediate credit and dishonored for insufficient funds after the credit was exhausted.

Second, checks drawn on The First National Bank and negotiated at Blanchard for immediate credit. After the credit was exhausted, the checks which were insufficient when drawn could have been returned by First National, but were paid because First National was fraudulently led to believe it was obligated on its guaranty to the Blanchard bank. Essentially what happened was that the false representations of Francis and the inclusion of fictitious serial numbers on the face of the checks shifted the Blanchard end of the kite loss to The First National Bank. These checks totaled $64,782.47.

Third, the minor portion of the loss consisting of some $30,000.00 was suffered not in the check kiting scheme it-

self, but as the result of fraud of the Francis brothers in the area of new and used car floor plan financing. The trial court apparently felt that the fraudulent intent of the Francis brothers in their dealings with both banks was such that it completely negated the meeting of the minds necessary to a loan and, therefore, held those transactions were not "loans."

It is petitioner's contention that the evidence in the record as a whole supports the trial court's judgment in regard to this third item of loss. However, the supporting evidence is not as obvious as in the other areas of loss. For this reason, petitioner, while not wishing to abandon its claims in this regard, will not unnecessarily lengthen this petition by further reference to the same.

With regard to the first and second areas of loss suffered as a direct result of the kiting of the Francis brothers, at trial, after detailing the evidence of the kite by testimony of other bank officers, petitioner offered the testimony of Curtis Brooks, the president of the bank, to show how the loss was handled in the bank. The trial court's finding of fact No. 14, Appendix A, *infra*, pp. vi-viii, constitutes a synopsis of the evidence offered through Mr. Brooks. This evidence alone supports the trial court's judgment characterizing the loss as a kite loss rather than a loan loss. The court in considering this evidence found in finding No. 20:

> "Plaintiff bank did not make a 'loan' to the Francis brothers by giving immediate credit on deposits, nor in obtaining notes from the Francis brothers on the 30th day of June, 1971, and the 3rd day of July, 1971, within the ordinary meaning of the word 'loan' as applied to banking or insurance; the Francis brothers

> received the amount of the net loss, to-wit: $121,324.38, from the Plaintiff bank. The Francis brothers obtained the money by the use of the checks. The checks were the basis of a false pretense; the Francis brothers did not request a loan in that regard from the Plaintiff bank; there was no loan agreement or meeting of minds on the terms of a loan. The amount of money obtained by the Francis brothers exceeded their loan limit; this was not a normal credit transaction and without the use of the checks the Francis brothers would not have received the money. I cannot find that either Plaintiff or the Francis brothers intended to negotiate a loan."

At the beginning of the trial, as reflected in the trial transcript at pages 19 through 21, at the close of petitioner's opening statement, the trial court inquired of petitioner's counsel what he perceived as being the contested fact questions in the case and the court was advised by counsel at that time that the primary fact question was whether or not the bank made the Francis brothers a loan when the loss was discovered. Again during the testimony of Curtis Brooks, at page 152 of the trial transcript, the trial court indicated that in its judgment there was no controversy concerning whether or not there was a loss, but that the controversy was how to characterize the loss. The central issue of the trial revolved around the bank's handling of the suspected kite and the losses resulting from that kite when the same was discovered. Petitioner submits that reasonable men may differ as to the interpretations to be given to the evidence presented in this case and obviously reasonable men have differed since the Honorable Judges of the Court of Appeals have disagreed with the trial court. However, the Court of Appeals should not substitute its

judgment for that of the trial court even though reasonable men might draw different inferences on the same evidence. As this Court held in *United States* v. *National Association of Real Estate Bds.*, 339 U.S. 485, "It is not enough that we might give the facts another construction, (or) resolve the ambiguities differently. . . ."

CONCLUSION

For these reasons a writ of certiorari should issue to review the judgment and opinion of the United States Court of Appeals, Tenth Circuit.

Respectfully submitted,

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March, 1975

APPENDIX A

FILED
NOV 14 1973
Rex B. Hawks
Clerk, U. S. District Court
By Zeta M. Cowan
Deputy

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF OKLAHOMA

THE FIRST NATIONAL BANK AND TRUST COMPANY, CHICKASHA, Plaintiff;	)	
vs.	)	No. CIV-73-63-E
THE CONTINENTAL INSURANCE COMPANY, Defendant.	)	

Kerry Caywood and Robert B. Park, 118 North Fourth Street, Chickasha, Oklahoma, Attorneys for Plaintiff.

Ben A. Goff, 2411 First National Center, Oklahoma City, Oklahoma, Attorney for Defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Before, LUTHER B. EUBANKS, United States District Judge.

FINDINGS OF FACT

1. Plaintiff, The First National Bank and Trust Company, Chickasha, Oklahoma, is a national banking corporation, licensed to do business and doing business at Chickasha, Oklahoma, and the Defendant, The Continental Insurance Company, is an insurance corporation, licensed to do business and doing business in the State of Oklahoma.

2. On the 3rd day of September, 1969, the Defendant, The Continental Insurance Company, made and issued its policy of insurance, the same being Banker's Blanket Bond Standard Form No. 24, introduced as Plaintiff's Exhibit No. 1, insuring Plaintiff against loss under the following coverage:

> (B) Any loss of Property through robbery, burglary, commonlaw or statutory larceny, theft, false pretenses, hold-up, misplacement, mysterious unexplainable disappearance, damage thereto or destruction thereof, whether effected with or without violence or with or without negligence on the part of any of the Employees, and any loss of subscription, conversion, redemption or deposit privileges through the misplacement or loss of Property, while the Property is (or is supposed to be) lodged or deposited within any offices or premises located anywhere, except in an office hereinafter excluded or in the mail or with a carrier for hire, other than an armored motor vehicle company, for the purpose of transportation.

That said coverage was in force for the protection of The First National Bank and Trust Company, Chickasha, Oklahoma, at the time of the loss complained of.

3. The First State Bank of Blanchard is a state banking corporation, doing business in Blanchard, Oklahoma.

4. W. C. Francis and Sons is a partnership, composed of Rene Francis and Herald Francis, brothers, operating a Ford Automobile Agency, selling new Ford vehicles and used vehicles at Blanchard, Oklahoma.

5. The Francis brothers floor planned their purchases of new Ford vehicles with Plaintiff bank and assigned security interests taken on some of their used and new vehicles to Plaintiff bank, with recourse. The Francis brothers partnership maintained checking accounts in both Plaintiff bank and The First State Bank of Blanchard.

6. W. C. Francis and Sons was required to pay for new Ford vehicles purchased from Ford Motor Company by Cashier's Check or money order delivered to the transport driver upon delivery by the driver of new Ford vehicles to W. C. Francis and Sons. To enable W. C. Francis and Sons to obtain Cashier's Checks and money orders for delivery to such transport drivers, Plaintiff bank, by letter dated January 24, 1969, advised First State Bank of Blanchard of its business transactions with Francis and Sons and made the following request:

> . . . New Ford vehicles are shipped to this firm on a C.O.D. basis and they are required to pay the convoy transport driver with either a certified check or a cashiers check for the vehicles that are being delivered to them at that particular time. When the delivery of the vehicle is made after normal banking hours, the convoy driver is required to telephone ahead to allow enough time for the dealer to be able to get to the bank for a cashiers check.
>
> This firm in the past has presented checks to you for cashiers checks. The checks presented to you will bear a new Ford serial number on the check and you are requested to issue your cashiers check for their check payable to Ford Motor Company identifying by serial number the vehicle for which the check is intended. These checks have been drawn on their account in this bank. If you will be so kind as to honor their request of having this cashiers check issued by your bank on their check drawn on this bank, this bank will guarantee payment of these checks for new Ford vehicles bearing a Ford serial number on the check presented to you. . . .

A copy of this letter was furnished to Rene Francis, one of the partners. By the terms of this letter, Plaintiff bank guaranteed to protect The First State Bank of Blanchard one hundred percent on checks bearing new Ford serial

numbers honored for the purchase of Cashier's checks to Ford.

7. Subsequent to the 24th day of January, 1969, the Francis brothers commenced a course of conduct whereby they would deposit to their account in the Blanchard Bank, for credit, checks drawn upon their account in the Plaintiff bank and would deposit in their account at Plaintiff bank checks drawn on the Blanchard Bank in amounts sufficient to cover the checks drawn on Plaintiff bank, as aforesaid, thereby creating an illusion of credit in both Plaintiff bank and the Blanchard Bank by a scheme commonly known as check kiting. The Francis brothers were permitted by both banks to draw on the uncollected funds represented by these deposits. This conduct of the Francis brothers continued until the closing of the accounts in early July, 1971: the monthly total of the dollar amounts of checks, counter deposited between the two banks, increased monthly from none in February, 1970, until in June of 1971, there was a total of $800,799.08 in checks drawn on the Francis account in Plaintiff bank deposited to the Francis account in the Blanchard Bank and an equivalent dollar value of checks drawn on the Blanchard Bank and deposited in their account on the Plaintiff bank. All of the checks drawn on Plaintiff bank and deposited at The First State Bank of Blanchard bore on their face what appeared to be a new Ford serial number. Total loan proceeds obtained from First National Bank during that month for the purchase of new Ford Automobiles was only approximately $130,000.00 and only approximately $19,000.00 in Cashier's Checks and money orders were purchased by the Francis brothers from the Blanchard Bank payable to Ford.

8. On June 28, 1971, the Francis brothers presented to Plaintiff bank checks dated June 26, 1971, totaling $30,751.08 drawn on their account in the Blanchard Bank. Of this total, $29,950.00 was presented for deposit and deposited to the Francis checking account and the balance, in the amount

of $881.88, was credited to payment on recourse notes held by Plaintiff. On June 29, 1971, Francis presented to The First National Bank checks dated June 28, 1971, totaling $34,373.21 drawn on their account in the Blanchard Bank. Of this total, $32,273.21 was presented for deposit and deposited to the Francis checking account in Plaintiff bank and the balance, consisting of one check in the amount of $2,100.00, was credited to payment on a note held by First National. The Francis brothers drew checks on the credit created by these two deposits until June 29, 1971; a new balance remained in the Francis account in The First National Bank in the amount of $962.85. The checks making up these two deposits were dishonored upon presentment to The First State Bank of Blanchard.

9. On June 28, 1971, the Francis brothers deposited for credit to their account in the Blanchard Bank checks dated the same date totaling $30,565.44 drawn on their account in Plaintiff bank and on June 29, 1971, the Francis brothers deposited for credit to their account in the Blanchard Bank checks dated the same date totaling $34,217.03, which were drawn on the Francis account in Plaintiff bank. All of these checks bore on their face what purported to be new Ford serial numbers, but which were later determined to be fictitious numbers. Francis drew checks on the credits created by these two deposits in the Blanchard Bank until on June 29, 1971, a balance remained in the Francis account in the Blanchard Bank in the amount of $6,881.16.

10. All of the checks written by the Francis brothers on their accounts in both banks on June 28 and June 29, 1971, were insufficient at the time they were drawn. On June 30, 1971, FDIC examiners in The First State Bank of Blanchard suspected the Francis brothers of kiting checks between the two banks and ordered those checks drawn on the Blanchard Bank and dated June 26, which were negotiated at First National Bank and Trust Company, returned for insufficient funds. On June 30, 1971, Robert Gilmore,

managing officer of the Blanchard Bank, personally returned those checks totaling $30,751.08 to The First National Bank in Chickasha unpaid. Subsequently, when the checks which were drawn on the Blanchard Bank and which had been presented to Plaintiff bank on June 29, 1971, were presented to the Blanchard Bank for payment, they too were returned by the Blanchard Bank for insufficient funds, but were returned to Plaintiff bank through regular channels. These checks totaled $34,373.21.

11. When the checks, dated June 28 and 29, 1971, drawn on The First National Bank and deposited by the Francis brothers at Blanchard, were presented to The First National for payment, there remained a balance of $962.85 in the Francis account; there were thirteen (13) such checks presented for payment totaling $64,782.47.

12. The total shortage in the insufficient checks was $129,906.76.

13. In the late afternoon of June 29, 1971, Robert Gilmore, managing officer of The First State Bank of Blanchard, notified Curtis Brooks, President of First National Bank and Trust Company, Chickasha, Oklahoma, that examiners suspected a kite involving the Francis accounts and further advised that checks would be returned unpaid for insufficient funds. On the morning of June 30, 1971, the Plaintiff bank called the Francis brothers in to attempt to find out the facts concerning the Francis brothers' accounts.

14. On the morning of June 30, 1971, the checks drawn on First State Bank of Blanchard, totaling $30,751.08, which had been negotiated at First National Bank and Trust Company on the 28th day of June, 1971, were being returned by Gilmore to the Plaintiff bank unpaid. Additionally the thirteen (13) checks, totaling $64,782.47 drawn on First National Bank which had been negotiated at the Blanchard Bank had arrived in the Plaintiff bank for payment. There was a collected balance of only $962.85 in the Francis account at Plaintiff bank at that time. The president of the

Plaintiff bank called the Francis brothers in to determine what the situation was with regard to the Francis brothers' accounts and to determine what checks, if any, Plaintiff bank was obligated to pay. The Francis brothers steadfastly insisted that there was no kite or check fraud of any nature involved in their account, that their business dealings were legitimate, and that they were purchasing automobiles represented by the checks drawn on First National Bank. These thirteen (13) checks bore on their face what purported to be new car serial numbers and Plaintiff bank did not know at that time that these checks had been in fact deposited to the Francis brothers' account at The First State Bank of Blanchard. The Plaintiff bank, therefore, arrived at the conclusion, based upon the representations of Francis and the fact that serial numbers appeared on the face of the checks, that they were obligated to pay the checks to the Blanchard Bank under the terms of the letter guaranty; further, credit had already been given for the checks drawn on The First State Bank of Blanchard and which were being returned by Gilmore; the credit had already been exhausted by the Francis brothers and the return of the checks would create an overdraft in the account. The Plaintiff bank then determined, rather than to show an immediate overdraft in the account and an immediate loss on the transaction and for the further purpose of protecting the capital structure of the bank and aiding it in recovery, if in fact it were later determined that the Francis brothers' representations were not true and that there was in fact a loss, Plaintiff had the Francis brothers sign a note in the amount of $88,760.50, which at that time appeared to be the total amount of potential loss to the bank. Francis brothers also signed a letter agreeing to furnish mortgages on all of the properties that they owned, including their homestead. Plaintiff bank then deposited the sum of $88,760.50 in the Francis brothers' account, charged the checks returned by Robert Gilmore against the account and paid the thirteen (13) checks which had been drawn on the account. Plaintiff was further per-

mitted by the officers of the Blanchard Bank to draw a draft on the collected balance of the Francis account in the Blanchard Bank and this collected balance of $6,881.16 was deposited to the Francis account in Plaintiff bank. Payment of the thirteen (13) checks was made on the first day of July, 1971, and subsequently the checks which had been negotiated by Francis at First National Bank on June 29, 1971, and which had been drawn on their account in the Blanchard Bank were returned through regular banking channels unpaid for insufficient funds. These checks totaled $34,373.21 and the Francis brothers were requested to sign a note in the amount of $33,302.22 for the same reasons and purposes as the previous note signed June 30, 1971.

15. It subsequently developed that the Francis brothers were without assets; that they were not in fact buying automobiles; that the serial numbers on the checks that had been presented to the Blanchard Bank drawn on First National were entirely fictitious; that the checks had been deposited to the Blanchard Bank rather than given to purchase Cashier's Checks and money orders to Ford; and that the Plaintiff bank was not in fact obligated to pay the checks under the terms of their letter guaranty to the Blanchard Bank.

16. The actions of the Francis brothers involved a series of acts which together constituted a scheme, a studied device, false pretenses built upon a series of false representations designed to lull both banks involved into a feeling of confidence and security. The Francis brothers intended to defraud both banks and by reason of the further fraudulent misrepresentations of the Francis brothers on the 30th day of June, 1971, at the Plaintiff bank, the entire loss was shifted to the Plaintiff bank.

17. The officers of The First State Bank of Blanchard became suspicious of the Francis brothers' activities prior to April 27, 1971, when they noted daily deposits to the Francis account of checks drawn on the Plaintiff bank and

received in their cash letter daily, checks drawn on the Blanchard Bank that had been deposited to the Plaintiff bank. Although the Blanchard Bank officers called daily thereafter to see if checks presented to them were good, the Blanchard Bank officers, though suspicious of the actions of the Francis brothers, did not advise the Plaintiff bank of their suspicions nor of their concern with regard to the apparent counter depositing of checks; nor did the officers of The First State Bank of Blanchard advise the Plaintiff bank at the time of payment of the thirteen (13) checks drawn on Plaintiff bank that the checks had not been used for the purchase of Cashier's Checks under the terms of the guaranty letter.

18. The Plaintiff bank suffered a loss on checks drawn on The First State Bank of Blanchard and negotiated at First National Bank in the amount of $65,124.29. Plaintiff suffered a loss on checks drawn on First National Bank and deposited at The First State Bank of Blanchard in the amount of $64,782.47. The total of these losses is $129,906.76. Against this total loss, Plaintiff was able to recover the collected balance of the Francis account at First State Bank of Blanchard in the amount of $6,881.16 and the collected balance in The First National Bank and Trust Company in the amount of $962.85. Additionally, later recoveries, as shown on the proof of loss filed by Plaintiff, reduced the loss by another $738.35, resulting in a total net loss on the check fraud of the Francis brothers in the amount of $121,-324.38.

19. The Banker's Blanket Bond Standard Form No. 24, in question, contains an exclusion, excluding:

> Any loss the result of the complete or partial non-payment of or default upon any loan made by or obtained from the Insured, whether procured in good faith or through trick, artifice, fraud or false pretenses, except when covered by Insuring Clause (A), (D) or (E).

20. Plaintiff bank did not make a "loan" to the Francis brothers by giving immediate credit on deposits, nor in obtaining notes from the Francis brothers on the 30th day of June, 1971, and the 3rd day of July, 1971, within the ordinary meaning of the word "loan" as applied to banking or insurance; the Francis brothers received the amount of the net loss, to-wit: $121,324.38, from the Plaintiff bank. The Francis brothers obtained the money by the use of the checks. The checks were the basis of a false pretense; the Francis brothers did not request a loan in that regard from the Plaintiff bank; there was no loan agreement or meeting of minds on the terms of a loan. The amount of money obtained by the Francis brothers exceeded their loan limit; this was not a normal credit transaction and without the use of the checks the Francis brothers would not have received the money. I cannot find that either Plaintiff or the Francis brothers intended to negotiate a loan.

21. With regard to the checks drawn on The First State Bank of Blanchard, negotiated at the Plaintiff bank and later dishonored, the loss occurred at the time the checks were presented to Plaintiff bank, credit given for the checks and that credit exhausted. With regard to the checks drawn on Plaintiff bank and deposited to The First State Bank of Blanchard, the loss occurred when the bank was induced to pay the checks by reason of the placing of fictitious serial numbers on the checks and the insistence of the Francis brothers that the checks were for the purchase of automobiles and the failure of the officers of The First State Bank of Blanchard to otherwise inform Plaintiff bank.

22. That the total check fraud loss of $121,324.38 was the result of a scheme to swindle and defraud Plaintiff bank.

23. W. C. Francis and Sons sold a retail installment contract to Plaintiff bank, with recourse, covering a 1971 Ford F-100 Pickup Truck, Serial No. F10YKKA196102. The pickup truck was never owned or received by Billy Moore, who signed the contract as purchaser. The original amount

due to Plaintiff on the contract was $4,645.44. All payments made on the contract were made by W. C. Francis and Sons. No payments were made after June 24, 1971, and Plaintiff suffered a loss on the contract in the amount of $4,004.74. Ford Motor Co. did not produce a pickup with this serial number.

24. W. C. Francis and Sons sold a promissory note and security agreement to the Plaintiff bank, with recourse, covering a 1969 Ford F-100 Half Ton Pickup, Motor No. F10YKC02228. The pickup truck was never owned by Marvin Teehee, the maker of the note; the original amount due to Plaintiff on the note was $3,515.40. All payments made on the contract were made by W. C. Francis and Sons. No payments were made after October 5, 1971, and Plaintiff suffered a loss on the note and security agreement in the amount of $447.79.

25. W. C. Francis and Sons sold a promissory note and security agreement to Plaintiff bank, with recourse, covering a 1967 Chevrolet Biscayne Two-Door Sedan. Francis later repossessed the vehicle and resold the same and did not remit the proceeds of the sale to Plaintiff. No payments were made on the contract after June 28, 1971, and Plaintiff suffered a loss in the amount of $706.90, the same being the unpaid balance of the note.

26. W. C. Francis and Sons executed a Promissory Note No. 91931 on the 17th day of June, 1971, the same being a floor plan note which was secured by security agreement on used automobiles. Two vehicles covered by the security agreement were sold by W. C. Francis and Sons and the proceeds of the sale not remitted to Plaintiff, resulting in a loss to Plaintiff in the amount of $3,600.00.

27. W. C. Francis and Sons executed Promissory Note No. 92000 and a security agreement covering new Ford Automobiles to secure the same in favor of Plaintiff on the 22nd day of June, 1971. The security listed on the security

agreement did not exist and the automobiles were never built by Ford Motor Company. Plaintiff suffered a loss of $4,765.00 when unable to realize a recovery on the collateral described in the security agreement.

28. W. C. Francis and Sons executed Note No. 92044 and a security agreement covering new Ford Automobiles on June 25, 1971. The automobiles described in this security agreement were never built by Ford Motor Company and were entirely fictitious as in Note No. 92000. Plaintiff bank suffered a loss in the amount of $19,200.00 as a result of being unable to realize any recovery on the non-existing collateral.

CONCLUSIONS OF LAW

1. Loss occasioned as a result of a check kiting scheme is a covered loss within coverage (B) of Banker's Blanket Bond Form No. 24, and money so obtained is not a loan within the meaning of the loan loss exclusion of said bond.

2. Plaintiff is entitled to judgment against the Defendant for the amount of the total of the insufficient checks drawn on both First National Bank and Trust Company, Chickasha, and First State Bank of Blanchard, which is $129,906.76, reduced by the collected balance of the account in The First State Bank of Blanchard in the amount of $6,881.16, and the amount of the collected balance in The First National Bank and Trust Compny, which was $962.85, and additional recoveries in the amount of $738.37 as shown by the proof of loss, resulting in a total net figure of $121,-324.38; which constitutes Plaintiff's loss as a direct result of the kiting of checks by the Francis brothers and their overall scheme to defraud Plaintiff bank.

3. There is no doubt in my mind that the Francis brothers had a deliberately devised scheme and plan to defraud the Plaintiff bank as is described in Finding No. 16, but assuming arguendo that there was no overall scheme to defraud the bank by means of the check kiting operation,

Plaintiff would still be entitled to judgment against the Defendant bonding company in the amount of the checks drawn on First State Bank of Blanchard and presented to Plaintiff as a loss occasioned when the Francis brothers obtained money from Plaintiff by false pretenses by means of false and bogus checks. Additionally, Plaintiff would be entitled to judgment against the Defendant bonding company for the amount of the checks drawn on Plaintiff bank less the collected balances and additional recoveries for the reason that that loss occurred by the false pretense of the Francis brothers by placing fictitious serial numbers on the face of the checks in question and further representing to the Plaintiff bank that they were not engaged in a check kiting scheme and that they were purchasing automobiles with the checks, thereby inducing Plaintiff to pay the checks under the belief that Plaintiff was so obligated by the terms of the guaranty letter furnished to First State Bank of Blanchard. A further contributing factor was the silence of the officers of First State Bank of Blanchard in the face of their suspicions concerning the existence of the check kite and their failure to advise Plaintiff bank at the time of payment of the checks drawn on Plaintiff bank that the same had not been issued for the purchase of Cashier's Checks or money orders. Silence under these circumstances constitutes an additional element of fraud.

4. Plaintiff is entitled to judgment against Defendant in the amount of $4,004.74 on the note signed by Billy Moore and in the amount of $447.79 on the note signed by Marvin Teehee. By the use of these two notes, the Francis brothers obtained money from The First National Bank and Trust Company by false pretenses. These transactions were not loans as such, but constituted the sale of fraudulent commercial paper and are not within the loan loss exclusion of the blanket bond. (*Johnstown Bank* v. *American Security Company of New York*, 174 N.Y.S.2d 385)

5. Plaintiff is entitled to judgment against the Defendant bonding company for the amount of loss suffered on the Don B. Ross note, in the amount of $706.90; Note No. 92000, in the amount of $4,675.00; Note No. 92044, in the amount of $19,200.00, and Note No. 91931, in the amount of $3,600.00, for the reason that said losses occurred as a part of the overall scheme of the Francis brothers to defraud Plaintiff bank and as such is a false pretense loss within coverage (B) of Banker's Blanket Bond Form No. 24 and is not a loan as that term is understood in the banking industry within the meaning of the loan loss exclusion.

6. Plaintiff is entitled to interest on the amounts due at six percent (6%) per annum from the date of loss, July 1, 1971, until the date of judgment (23 O.S. § 22, Okla. Stat. 1971; *First National Bank of Cushing, Oklahoma* v. *Security Mutual Casualty Company*, 431 F.2d 1025; *Phoenix Insurance Company* v. *Diffie*, 270 P.2d 634), and at ten percent (10%) per annum from the date of judgment, until paid. (12 O.S. § 727, Okla. Stat. 1971)

Counsel for Plaintiff will prepare an appropriate judgment and submit it to the Court for approval within five (5) days from this date.

The Clerk of the Court is directed to mail a copy hereof to counsel of record.

DATED this 14th day of November, 1973.

s/ Luther B. Eubanks
Luther B. Eubanks
United States District Judge

APPENDIX B

FILED
NOV 16 1973
Rex B. Hawks
Clerk, U. S. District Court
By Zeta M. Cowan
Deputy

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF OKLAHOMA

THE FIRST NATIONAL BANK AND TRUST COMPANY, CHICKASHA, OKLAHOMA, Plaintiff,	)	
-vs-	)	No. CIV-73-63-E
THE CONTINENTAL INSURANCE COMPANY, Defendant.	)	

JOURNAL ENTRY OF JUDGMENT

The Court having filed its findings of fact and conclusions of law herein, directing the entry of judgment in favor of plaintiff and against the defendant it is:

ORDERED, ADJUDGED AND DECREED That plaintiff, The First National Bank and Trust Company, Chickasha, Oklahoma, do have and recover of the defendant, The Continental Insurance Company, the principal sum of $153,958.81; together with interest thereon at the rate of six percent (6%) per annum, from the 1st day of July, 1971, to the 14th day of November, 1973, totaling $21,913.00, making a total judgment in the amount of $175,871.81, plus interest thereon at the rate of ten percent (10%) per annum, from

this date until paid; together with all costs of this action accrued and accruing.

Dated this 16th day of November, 1973.

s/ Luther B. Eubanks
Luther B. Eubanks
United States District Judge

ENTERED IN JUDGMENT DOCKET ON NOV. 16, 1973
ADELAIDE HOLSTON, DEPUTY

APPROVED:

PARK, NELSON & CAYWOOD
By Kerry W. Caywood
Attorneys for Plaintiff

RHODES, HIERONYMUS, HOLLOWAY & WILSON
By Ben A. Goff
Attorneys for Defendant

APPENDIX C

UNITED STATE COURT OF APPEALS
TENTH CIRCUIT

NO. 74-1160

THE FIRST NATIONAL BANK AND TRUST COMPANY, CHICKASHA, OKLAHOMA,	)	
Plaintiff-Appellee,	)	Appeal from the
v.	)	United States District
	)	Court for the Western
THE CONTINENTAL INSURANCE COMPANY,	)	District of Oklahoma
	)	(D.C. No. Civ. 73-63-E)
Defendant-Appellant.	)	

Kerry W. Caywood (Park, Nelson & Caywood, on the brief), for Plaintiff-Appellee.

Ben A. Goff (Rhodes, Hieronymus, Holloway & Wilson, on the brief), for Defendant-Appellant.

Before SETH, McWILLIAMS and BARRETT, Circuit Judges.

McWILLIAMS, Circuit Judge.

FILED JANUARY 10, 1975

This is a dispute between an insurance company and its insured and the issue here to be resolved is whether a loss suffered by the insured, a bank, is covered by a bankers blanket bond. The insurance company defended on the ground that the loss incurred was a loan loss and, as such, an excluded risk. In a trial to the court, sitting without a jury, the trial court held that the loss suffered by the insured was not a loan loss, and that the loan exclusion was therefore inapplicable. Accordingly, the trial court entered judgment in favor of the insured and against the insurance company in a total amount of $175,871.81. The insurance company now appeals, contending that the entire loss was a loan loss, and as such an excluded risk. We agree. In our view the findings and conclusions of the trial court are not supported by the record and are clearly erroneous. In order to demonstrate such, the facts must be summarized in considerable detail.

The Continental Insurance Company, hereinafter referred to as the Insurer, issued a Bankers Blanket Bond, Standard Form No. 24, to the First National Bank and Trust Company, Chickasha, Oklahoma, hereinafter referred to as First National, which bond was in force and effect when First National suffered the losses here involved. The insuring provision under which First National, the insured, seeks to hold liable the Insurer reads as follows:

"(B) *Any loss of Property through* robbery, burglary, commonlaw or statutory larceny, theft, *false pretenses*, hold-up, misplacement, mysterious unexplainable disappearance, damage thereto or destruction thereof, whether effected with or without violence or with or without negligence on the part of any of the Employees, and any loss of subscription, conversion, redemption or deposit privileges through the misplacement or loss of Property, while the Property is (or is supposed to be) lodged or deposited within any offices or premises located anywhere, except in an office hereinafter excluded or in the mail or with a carrier for hire, other than an armored motor vehicle company, for the purpose of transportation." (Emphasis added).

The bond further provides that there is no coverage of several excluded risks, one of which reads as follows:

"This bond does not cover:

* * * * * *

"(d) Any loss the result of the complete or partial non-payment of or default upon any loan made by or obtained from the Insured, whether procured in good faith or through trick, artifice, fraud or false pretenses, except when covered by Insuring Clause (A), (D) or (E)."

The loss, or losses, for which First National seeks recovery occurred on or around July 1, 1971, and arose out of First National's long business relationship with W. C. Francis & Sons, an automobile dealership in nearby Blanchard, Oklahoma, which company will hereinafter be referred to as Francis.

Francis was a Ford agency and dealt in new and used cars. As indicated, though First National's losses occurred during June and July 1971, it had been financing Francis for more than ten years prior thereto. Francis floor planned the purchase of its new automobiles through First National

by borrowing money to pay Ford Motor Company, and in turn executing promissory notes in favor of First National, with the acquired vehicles being given as security for such notes. Many of the vehicles sold by Francis, be they new or used, were sold on the installment plan, and in connection therewith First National down through the years had purchased, with recourse, much commercial paper from Francis. Additionally, First National from time to time would simply loan money to Francis, which in turn would sign a note in favor of First National for the money thus loaned, giving collateral of various kinds as security. The foregoing illustrates the general nature of the business relationship between First National and Francis, which, as indicated, was of long standing, and over the years involved the advancing of considerable sums of money by First National. Francis maintained a checking account in First National and the loan proceeds were generally channeled into that account.

The Ford Motor Company insisted that Francis pay for new automobiles as they were delivered, which required Francis to have a cashier's check, or a certified check, in hand at the precise moment the new vehicles arrived. Francis was located in Blanchard, Oklahoma, somewhat removed from Chickasha, and this fact necessitated considerable travel back and forth between Blanchard and Chickasha by Francis in order that it might have a cashier's check to pay Ford Motor Company at the moment of a delivery. To minimize this inconvenience, in early 1969 First National and Francis decided that the latter should use its checking account in the First State Bank in Blanchard, hereinafter referred to as Blanchard Bank, to obtain the cashier's checks needed for payment of newly delivered cars. It was agreed that Francis would present to Blanchard Bank checks drawn by Francis on its checking account in First National. Such checks were to identify by serial number the particular vehicle for which the cashier's check was being given. On presentment of such a check, Blanchard Bank agreed to

immediately give Francis a cashier's check in the amount of the deposit, and in turn First National guaranteed payment to Blanchard Bank of the checks thus drawn on it by Francis. This entire arrangement was finalized in a letter dated January 24, 1969, sent by a vice-president of First National to Blanchard Bank, which reads as follows:

> " * * * New Ford vehicles are shipped to this firm on a C.O.D. basis and they are required to pay the convoy transport driver with either a certified check or a cashier's check for the vehicles that are being delivered to them at that particular time. When the delivery of the vehicle is made after normal banking hours, the convoy driver is required to telephone ahead to allow enough time for the dealer to be able to get to the bank for a cashiers check.
>
> "This firm in the past has presented checks to you for cashiers checks. The checks presented to you will bear a new Ford serial number on the check and you are requested to issue your cashiers check for their check payable to Ford Motor Company identifying by serial number the vehicle for which the check is intended. These checks have been drawn on their account in this bank. If you will be so kind as to honor their request of having this cashiers check issued by your bank on their check drawn on this bank, this bank will guarantee payment of these checks for new Ford vehicles bearing a Ford serial number on the check presented to you. * * * "

This arrangement between First National, Blanchard Bank and Francis went into effect in early 1969. It should be mentioned that not only did Francis use its account in Blanchard Bank to pay for newly acquired vehicles, but also drew on the account to pay for many of its day-to-day operating expenses.

Although Francis never did admit such, it would appear that soon after First National guaranteed payment of

checks drawn on it by Francis, the latter began an extensive check kiting operation involving deposits and counter-deposits back and forth between its checking accounts in Blanchard Bank and First National. As illustrative of its check kiting proclivities, Francis would, for example, present for deposit in its account in Blanchard Bank a check drawn to its account in First National, where there were at the time insufficient funds to cover the check in question. The check thus presented bearing the serial number of a Ford Motor vehicle, Blanchard Bank would immediately issue a cashier's check in the amount of the deposit. On other occasions a check drawn on First National but bearing a fictitious Ford vehicle serial number would merely be deposited in Francis' checking account, with no cashier's check being given in return therefor, and Blanchard Bank would then allow Francis to immediately draw checks on the amount so deposited.

To cover such withdrawals from its account in First National, Francis would simultaneously deposit a like amount in its account in First National in the form of checks drawn on its account in Blanchard Bank, and First National would allow Francis to immediately draw upon such deposit. As indicated, this check kiting operation apparently commenced in early 1970 and thereafter grew in volume until during the month of June 1971 there was approximately $800,000 in checks drawn on First National and deposited in the Francis account in Blanchard Bank, and an equivalent dollar value of checks drawn on Blanchard Bank and deposited in the Francis account in First National.

On June 29, 1971, examiners of the Federal Deposit Insurance Corporation alerted Blanchard Bank to the possibility of a check kiting operation. Because of insufficient funds in the Blanchard account, the examiners instructed Blanchard Bank to return, unpaid, Francis' checks drawn on Blanchard Bank and presented for payment by First National. On the same day, checks drawn on First National and negotiated at Blanchard Bank arrived at First National

for payment. There were then insufficient funds in the Francis account for these items.

When First National was thus alerted to the possibility of a check kite, it called in the Francis brothers, Rene and Harold, for an explanation. The Francis brothers denied check kiting or any other misconduct, and asserted they had ample security to cover all overdrafts. Because of such reassurances and because First National believed it was obligated on its letter of guaranty to Blanchard Bank, First National on June 30, 1971, credited $88,760.50 to the Francis account at First National to cover the overdrafts. This transaction was treated as a loan by all parties with Francis signing a note in that amount in favor of First National and with First National carrying the credit on its loan account books. It soon developed that this was not a sufficient amount to cover additional overdrafts in the Francis account and two days later, on July 2, 1971, First National loaned Francis an additional sum of $33,302.22 by crediting Francis' account with that amount, Francis again signing a promissory note. Both notes were accompanied by pledges of collateral which never materialized.

Francis paid only a very small amount on either of the aforesaid notes and later went out of business. After allowing certain credits and adjustments, the unpaid balance due on these two notes amounted to $121,324.38. Such sum, according to First National, is a loss caused by check kiting and represents a "loss of property through * * * false pretenses." Conversely, the Insurer contends that this was a loan loss and an excluded risk under Exclusion (d). The trial court found that this loss was the result of a check kite, rather than a bad loan, and that under the provisions of the blanket bond the Insurer was liable to First National for its loss. Since this sum represents the major part of the judgment ultimately awarded First National, the total judgment being $175,871.81, we shall first consider the problem of the nature of the loss.

Numerous courts have held that a check kite operation which results in a loss of money to a bank does constitute a "loss of property through false pretenses," as that phrase is used in a bankers blanket bond of the type here under consideration. In so holding, these courts have rejected the argument that inasmuch as the depositor is himself legally liable to the bank, there is in reality a "loan" from the bank to the check kiter, and as such an excluded risk. *See*, for example, such cases as First National Bank of Decatur v. Insurance Co. of North America, 424 F.2d 312 (7th Cir. 1970); United States v. Western Contracting Corporation, 341 F.2d 383 (8th Cir. 1965); Fidelity & Casualty Company v. Bank of Altenburg, 216 F.2d 294 (8th Cir. 1954); and Hartford Accident & Indemnity Co. v. Federal Deposit Ins. Corp., 204 F.2d 933 (8th Cir. 1953).

Accordingly, under the authorities above cited, if the instant case involved a loss of property occasioned by a *pure* checking operation, First National would be entitled to recover under its blanket bond. The Insurer itself agrees that such would be the result if the ultimate loss was in fact caused by a check kite. The Insurer asserts, however, that the real cause of First National's loss was Francis' failure to repay the loan. We agree.

When First National was alerted to the possibility of a check kite scheme, the Francis brothers were called in for an explanation. Apparently the explanation was convincing, because First National immediately loaned Francis additional sums totaling $122,062.72, and credited Francis' checking account with that amount. In return for such advances, Rene and Harold Francis executed two separate promissory notes to First National, secured by pledges of their individual and personal assets. On such a fact situation, First National sustained no loss as a result of the check kite, as the overdrafts were covered, in effect, by First National itself, which in turn received the promissory notes of Francis in exchange for the advances thus made. The

"loss" was incurred by First National when Francis later defaulted on its notes. This is clearly a bad loan loss, subject to the exclusion, and the trial court erred in concluding to the contrary.

In this general connection it is interesting to note that when First National initially "uncovered" the check kiting scheme, it made no claim of a loss incurred as a result thereof. Rather than have its financial statement reflect such a bad check loss, it preferred to loan the amount of the overdrafts to Francis and then carry the latter's promissory notes in its loan accounts. That First National itself did not regard its loss as one resulting from a check kite and within the coverage of its bond is also evidenced by the fact that in a letter to the Insurer, dated August 9, 1971, the president of First National stated, "It would appear to me at this moment that the loss is ours unless civil liability can be established through legal action." The "civil liability" thus referred to was presumably against Francis, or Blanchard Bank, as there is nothing to indicate that First National was contemplating action against the Insurer. On the contrary, First National thought the "loss is ours."

First National's loss being occasioned by a bad loan, it is an excluded risk under Exclusion (d) of the bond. The fact that Francis may well have made false statements in securing the loan, and pledged fictitious or nonreachable collateral, does not alter the fact that the loan thus obtained comes within the Exclusion (d). As indicated, the exclusion provides that the bond does not cover any loss which results from complete or partial nonpayment of any loan made by the Insured, "whether procured in good faith or through trick, artifice, fraud or false pretenses." In short, the exclusion fits the facts of the instant case most precisely, i.e., a loan secured through fraud and deceit. For cases holding that a loan induced by extrinsic falsity, such as a pledge of nonexistent collateral, is within an exclusion clause of the type with which we are here concerned, *see* such cases as Bank of Southwest v. Nat'l Surety, 477 F.2d

73 (5th Cir. 1973); Maryland Casualty Co. v. State Bank & Trust Co., 425 F.2d 979 (5th Cir. 1970); East Gadsen Bank v. U. S. Fidelity & Guaranty Co., 415 F.2d 357 (5th Cir. 1969); and State Bank of Poplar Bluff v. Maryland Casualty Co., 289 F.2d 544 (8th Cir. 1961).

The remaining items of "loss" awarded by the trial court in its judgment were unrelated to the check kiting operations. The trial court concluded that three promissory notes, representing monies loaned Francis by First National and for which Francis executed promissory notes, did not come within the exclusion clause because they were part of the overall scheme to defraud First National and were in fact secured by nonexistent collateral. Under the authorities above cited, such fact, i.e., nonexistent or fictitious collateral, does not mean that a loan valid on its face is outside the terms of the exclusion. The balance due on these three notes totaled $27,475 and the trial court erred in awarding First National judgment for that amount.

The balance of the judgment, exclusive of the prejudgment interest allowed by the trial court, was in the sum of $5159.43, and represented installment contracts and notes executed by purchasers of cars from Francis, which commercial paper First National in turn purchased, with recourse, from Francis. In these cases, the collateral never originally existed or was sold and Francis never fully remitted the proceeds to First National. The trial court concluded that this was not a "loan" of money, but was simply the purchase of commercial paper. We do not agree. The officer of First National who was in charge of First National's myriad dealings with Francis candidly admitted that in purchasing, with recourse, these installment contracts and notes, First National was simply "financing the Francis brothers by buying paper" and that it was just as though it had loaned money to Francis and taken the latter's promissory note in exchange therefor. Such was but a part of First National's continuing financing of the Fran-

cis dealership. *See* Twin City Federal Savings & Loan v. Transamerica Ins. Co., 413 F.2d 494 (8th Cir. 1969).

Though we have ourselves devoted considerable attention to the check kiting aspect of this case, we have done so only in an effort to demonstrate that the check kite is not really the crux of the case. As indicated, First National did not cease its dealings with Francis when warned of a check kite, but on the contrary proceeded to loan Francis a sum well over $100,000. The important aspect of this case is the fact that for some ten years First National had been financing the Francis dealership by making countless loans, in one form or another. And when the Francis dealership folded, First National was left with unpaid loans. Such loss was an excluded risk.

Judgment reversed and cause remanded with directions that the trial court enter a judgment in favor of the Insurer dismissing First National's action.

APPENDIX D

NOVEMBER TERM—JANUARY 29, 1975

Before Honorable Oliver Seth, Honorable Robert H. McWilliams, and Honorable James E. Barrett, Circuit Judges

THE FIRST NATIONAL BANK AND TRUST COMPANY, CHICKASHA, OKLAHOMA,	)	
Plaintiff-Appellee,	)	
v.	)	No. 74-1160
THE CONTINENTAL INSURANCE COMPANY,	)	
Defendant-Appellant.	)	

This matter comes on for consideration of the Petition for Rehearing filed by Appellee in the captioned cause.

Upon consideration whereof, the Petition for Rehearing is denied.

s/ Howard K. Phillips
HOWARD K. PHILLIPS
Clerk

A true copy
Teste
Howard K. Phillips
Clerk, U. S. Court of
Appeals, Tenth Circuit

By Anne Cabot
Deputy Clerk

APPENDIX E

JANUARY TERM—FEBRUARY 10, 1975

Before The Honorable Oliver Seth, The Honorable Robert H. McWilliams and The Honorable James E. Barrett, Circuit Judges

THE FIRST NATIONAL BANK AND TRUST COMPANY, CHICKASHA, OKLAHOMA,	)	
Plaintiff-Appellee,	)	
vs.	)	No. 74-1160
THE CONTINENTAL INSURANCE COMPANY,	)	
Defendant-Appellant.	)	

This matter comes on for consideration of appellee's motion for stay of mandate pending application for a petition for writ of certiorari.

Upon consideration whereof, it is ordered that the mandate is stayed to and including March 17, 1975 only, pending the timely filing by appellees of a petition for writ of certiorari in the Supreme Court of the United States. If, on or before that date, the Clerk of this Court shall receive notice from the Clerk of the Supreme Court of the United States that a timely petition for writ of certiorari has been filed in that Court, the stay of mandate shall continue until final disposition by the Supreme Court.

HOWARD K. PHILLIPS, Clerk

s/ By Robert L. Hoecker
Robert L. Hoecker
Chief Deputy Clerk

A true copy
Teste
Howard K. Phillips
Clerk, U. S. Court of
Appeals, Tenth Circuit

By Mary A. Sherman
Deputy Clerk

CERTIFICATE OF SERVICE

I, Kerry W. Caywood, do hereby certify that three true and correct copies of the foregoing Petition for Writ of Certiorari to the United States Court of Appeals, Tenth Circuit, was deposited in the United States Post Office, with first class postage prepaid, addressed to Ben A. Goff, Rhodes, Hieronymus, Holloway & Wilson, Attorneys at Law, 2411 First National Center, Oklahoma City, Oklahoma 73102.

Kerry W. Caywood

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MISCELLANEOUS:

Federal Rules of Civil Procedure, Rule 52(a) 1, 10

In the

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1149

THE FIRST NATIONAL BANK AND TRUST COMPANY,
CHICKASHA, OKLAHOMA,
Petitioner,

VERSUS

THE CONTINENTAL INSURANCE COMPANY,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT

QUESTIONS PRESENTED

The Respondent would agree with the contention of the Petitioner that the only question properly presented to the Supreme Court of the United States by virtue of this Petition for Writ of Certiorari is the question of whether the United States Court of Appeals, Tenth Circuit, properly exercised its appellate function under Rule 52(a) of the Federal Rules of Civil Procedure, which specifies that the findings of fact made by a District Court, sitting without a jury, are not to be set aside unless clearly erroneous.

STATEMENT OF CASE

For the purposes of the Petition for Writ of Certiorari to the United States Court of Appeals, Tenth Circuit, the Respondent, the Continental Insurance Company, accepts the statement of case as set out by the Petitioner in the Petition for Writ of Certiorari.

REASONS RELIED ON IN OPPOSITION OF WRIT

1. THE APPLICATION OF AN INSURANCE CONTRACT TO AN UNCONTROVERTED SET OF FACTS BY THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT, WAS A PROPER EXERCISE OF THE APPELLATE FUNCTION OF THAT COURT.

Where, as in this case, the facts give rise to the necessity for construction of an insurance policy, the Federal Courts applying Oklahoma law have consistently held that the interpretation of an insurance policy, like any other contract, is a question of law for the Court. See *Gulf Insurance Company* v. *Gold Cross Ambulance Service Co.*, 327 F.Supp. 149; *Western Casualty and Surety Company* v. *Pacific Employees Insurance Company*, 97 F.Supp. 956. Thus, it is the Respondent's position that, having determined the facts and circumstances of the transaction in question, the District Court was then faced wtih the problem of construction of the insurance policy to determine whether those facts gave rise to coverage or exclusion of coverage under the policy. In the light of the *Gulf Insurance* and the *Western Casualty* cases, cited above, it seems clear that the judicial determination of those questions is a determination of law and not of fact.

In further support of this position, the Respondent would show the Court that the trial court found, as a conclusion of law, that "loss occasioned as a result of a check kiting scheme is a covered loss within coverage (B) of Bankers Blanket Bond Form No. 24, and money so obtained is not a loan within the meaning of the Loan-Loss Exclusion of said Bond." Thus, the trial court indicated that its finding, *i.e.*, that the loss sustained by the Petitioner, the First National Bank and Trust Company, Chickasha, Oklahoma, was not within the exclusion of the Bankers Blanket Bond, is a conclusion of law and not a conclusion of fact as the Petitioner urges.

In the Petition for Writ of Certiorari filed herein, the Petitioner urges that, "whether a transaction constitutes a loan of money is a question of fact, not of form." In support of this position, the Petitioner cites the Oklahoma case of *Cobb* v. *Baxter*, 292 P.2d 389 (Okla. 1956). The Respondent would respectfully show the Court that, in the cited case, the Oklahoma Supreme Court considered the question of the existence of a loan for an entirely different purpose than the question which is presented here. The *Cobb* decision concerned the question of whether or not a specific transaction violated the Oklahoma statute prohibiting usury. That statute applied only to loans of money, and has since been repealed. In the *Cobb* case, a seller of goods had attempted to conceal his usurious interest charges behind the facade of a conditional sales contract calling for installment payments and carrying charges. Thus, the Oklahoma Supreme Court was faced with the question of whether or not the transaction was a "loan of money" within the mean-

ing of the usury statute where the transaction was clearly designed to appear to be other than a loan.

In answer to the question presented by the facts of the *Cobb* case, the Oklahoma Supreme Court did, indeed, hold that the question of whether a transaction constitutes a loan of money is a question of fact and not of form. However, nowhere in that case, and in no case which comes to the Respondent's hand, did the Oklahoma Supreme Court hold that whether a transaction constitutes a loan of money is always a question of fact for the jury. That Court has merely held that whether or not a transaction is a loan of money must be determined by a close examination of the facts and circumstances surrounding the transaction, and not by a mere review of the form of the transaction.

Further, at the trial of this matter, extensive documentary evidence was introduced concerning the various transactions which occurred between the Francis Brothers and both the First National Bank of Chickasha, and the First National Bank of Blanchard. As a result of this extensive documentation, the evidence was virtually uncontroverted as to the circumstances surrounding those transactions. The Federal Courts, again construing Oklahoma law, have held that where there was no material conflict of introduced evidence as to factual occurrences, question of law was presented as to contractual construction. *Sweeney and Myers* v. *Empire State Insurance Company of Watertown, New York*, 130 F.Supp. 729, *rev.* 228 F.2d 770. This is plainly the situation in the case now at bar. The trial court made extensive findings of fact, most or all of which were based on evidence which was uncontroverted at trial. Having made those conclusions of fact, the trial

court then proceeded to determine, as a matter of law, the coverages and exclusions of the Bankers Blanket Bond which applied to the loss. The United States Court of Appeals, Tenth Circuit, relying on the same findings of fact, reached an entirely different conclusion of law. The Petitioners argue that in doing so, the United States Court of Appeals, Tenth Circuit, did not properly exercise its appellate function. The Respondent believes, and urges this Court to the view, that the Court of Appeals for the Tenth Circuit did no more than reverse the trial court's conclusions of law, and therefore, properly exercised its appellate function.

2. THE JUDGMENT OF THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT, IS SUPPORTED IN THE RECORD.

No more than a review of the trial court's findings of fact is required to support the conclusion of the Court of Appeals for the Tenth Circuit. The uncontroverted evidence was that an auto dealership operated by the brothers, Rene and Herald Francis was financed by the Petitioner bank; that on June 29, 1971, the Petitioners discovered a scheme involving the Francis brothers' checking account with the Petitioner and the First State Bank of Blanchard, as well as other types of loan frauds. Since the Petitioner presents no argument that the Court of Appeals erred in reversing the trial court as to its application of the Loan Loss Exclusion to the frauds not involving the checking account, it is assumed they concur with the correctness of that ruling. The only issue presented in their petition involves the loss which arose in connection with the checking account. The relevant Finding of Fact No. 14 of the trial court reads, in part: "The

Plaintiff's bank then determined, rather than to show an immediate overdraft on the account and an immediate loss on the transaction, and for the further purpose of protecting capital structure of the bank and aiding it in recovery, if in fact it were later determined that the Francis brothers' representations were not true and that there was in fact a loss, Plaintiff had the Francis brothers sign a note in the amount of $88,760.50, which, at that time, appeared to be the total amount of potential loss to the bank. The Francis brothers also signed a letter agreeing to furnish mortgages on all of the property that they owned, including their homestead. Plaintiff bank then deposited the sum of $88,-760.50, in the Francis brothers' account, charged the checks returned by Robert Gilmore against the account and paid the thirteen (13) checks which had been drawn on the account. Plaintiff was further permitted by the officers of the Blanchard bank to draw a draft on the collected balance of the Francis account in the Blanchard bank and this collected balance of $6,881.16 was deposited to the Francis account in Plaintiff bank. Payment of the thirteen (13) checks was made on the first day of July, 1971, and subsequently the checks which had been negotiated by Francis at First National Bank on June 29, 1971, and which had been drawn on their account in the Blanchard bank were returned through regular banking channels unpaid for insufficient funds. These checks totaled $34,373.21 and the Francis brothers were requested to sign a note in the amount of $33,302.22 for the same reasons and purposes as the previous note signed June 30, 1971."

Thus, the trial court found that an advancement of money, secured by a note, was made to the Francis brothers

after the bank learned of the overdrawn state of the Francis account. The trial court refused to characterize the resulting loss as an excluded loan loss. The Court of Appeals for the Tenth Circuit disagreed. Since there was no controversy as to what happened after the overdraft was discovered, the characterization of the transaction was a pure question of law. The Court of Appeals not only had the right to review this issue, but was compelled to do so since the ruling of the trial court was contrary to the uncontroverted evidence.

The Respondent would further show the Court that the trial court gave considerable weight to the elements of fraud involved in the transactions between the Francis brothers and the Petitioner. In following this logic, the trial court found that the bank's loans to the Francis brothers were not really loans because of the fraudulent intent of the Francis brothers. The trial court found, in Conclusion of Law No. 3, "there is no doubt in my mind that the Francis brothers had a deliberately devised scheme and plan to defraud the Plaintiff Bank as is described in Finding No. 16 but assuming arguendo that there was no overall scheme to defraud the Bank by means of the check kiting operation, Plaintiff would still be entitled to judgment against the Defendant Bonding Company in the amount of checks drawn on First State Bank of Blanchard and presented to Plaintiff as a loss occasioned when the Francis brothers obtained money from Plaintiff by false pretenses by means of false and bogus checks." The trial court found in Finding of Fact No. 19, "the Bankers Blanket Bond Standard Form No. 24 in question, contains an exclusion, excluding:

> " 'Any loss as the result of the complete or partial non-payment of or default upon any loan made by or obtained from the insured, whether procured in good faith or through trick, artifice, fraud or false pretenses, except when covered by insuring clause (A) (D) or (E).' "

The clear and unambiguous import of this language is that even though procured by reason of fraud or false pretense, as in this case, a loan loss is specifically excluded from the coverage of the insurance policy. Thus, the "deliberately devised scheme and plan to defraud the Plaintiff Bank" becomes immaterial to the coverage of the policy under circumstances where the scheme culminates in a loan transaction.

It cannot be said that the Petitioner Bank merely altered the form of the loss from a check kite to a loan loss by taking notes and pledges of collateral. The Petitioner, after having become fully aware of the Francis brothers' overdrawn status of their account, and relying upon the Francis brothers' own protestations of the legitimacy of their operations, concluded to make cash advancements in the amount of over $120,000.00 to the Francis brothers by means of depositing the cash in the Francis brothers' checking account with the Petitioner Bank. Had the Petitioner determined at that time to return the Francis brothers' checks, dishonored by reason of insufficient funds, to the First State Bank of Blanchard, the Petitioner Bank *might* have suffered the loss for which insurance coverage is herein claimed but for only half the amount claimed. The loss was occasioned not by the Francis brothers' check kiting scheme, but by the Petitioner's decision to advance money

to the Francis brothers on notes and a promise to give collateral which was dishonored.

Finally, citing *Bank of Southwest* v. *National Surety*, 477 F.2d 73 (5th Cir. 1973); *Maryland Casualty Company* v. *State Bank and Trust Company*, 425 F.2d 979 (5th Cir. 1970); *East Gadsden Bank* v. *U. S. Fidelity and Guaranty Company*, 415 F.2d 357 (5th Cir. 1969); *State Bank of Poplar Bluff* v. *Maryland Casualty Company*, 289 F.2d 544 (8th Cir. 1961), the United States Court of Appeals, Tenth Circuit, concluded that "as indicated, the exclusion provides that the Bond does not cover any loss which results from complete or partial non-payment of any loan made by the Insured, 'whether procured in good faith, or through trick, artifice, fraud or false pretenses.' In short, the exclusion fits the facts of the instant case most precisely, i.e., a loan procured through fraud and deceit." The Respondent would respectfully urge this Court, in the light of all the facts, that this conclusion, reached by the Court of Appeals for the Tenth Circuit, after careful consideration of the circumstances of this case, is inescapable.

CONCLUSION

Rule 19 of the Rules of the Supreme Court of the United States reads, in pertinent part, that a Writ of Certiorari to a United States Court of Appeals should be granted where that Court "has so far departed from the accepted and unusual course of judicial proceedings, or so far sanctioned such a departure by a lower Court as to call for an exercise of this Court's power of supervision." In the instant case, the Petitioner has made no such showing of such a radical departure from the accepted standards of

Appellate procedure. The United States Court of Appeals, Tenth Circuit, proceeded in a manner which was well within the scope of Appellate review permitted by Rule 52(a), Federal Rules of Civil Procedure. That Court ruled that the judicial construction placed upon the Contract of Insurance in the instant case by the trial court was clearly erroneous, and necessitated reversal of the decision below. The Appellate Court made no finding of facts. Neither did the Appellate Court challenge the trial court's decision as to the weight and credibility of the evidence. Rather, the Appellate Court carefully reviewed the Findings of Fact as made by the trial court and determined that, as a matter of law, those facts compel a result contrary to that reached at trial.

For the foregoing reasons, the Respondent prays that the Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit be denied.

Respectfully submitted,

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March, 1975

CERTIFICATE OF SERVICE

This is to certify that the foregoing Brief in Opposition to Petition for Writ of Certiorari has been served on Counsel for Petitioner this _____ day of April, 1975, by mailing three copies, postage fully paid, to:

Kerry W. Caywood
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_____
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